Subject: Alternative Student Loan Program

Description

All states are permitted to issue tax-exempt bonds, within certain limits, for the support of specific public purpose project. These projects, by IRS rule, include student loans.

Borrowing through “Alternative Student Loan” programs has become a fact of life for thousands of students in Washington. An opportunity has presented itself to develop a new alternative student loan program using tax exempt bonds. The intent is to offer certain financial advantages to student borrowers that would not otherwise be available to them.

By using tax-exempt state bond authority, the cost-of-funds can be reduced and the savings passed on to the student, generally in the form of lower fees or interest rates. This is also an opportunity for the state to target the benefit to particular groups and kinds of students.

The opportunity comes about because the Student Loan Finance Authority (SLFA), the non-profit entity that in past years had used the tax-exempt bonds, has subsequently become part of a for-profit enterprise and is now ineligible to participate in the bond program. The SFLA had used the funds to support a secondary market function.

The staffs of the Higher Education Coordinating Board (HECB) and the Washington Higher Education Facilities Authority (WHEFA) have been investigating the potential to use the funds to develop an alternative student loan program. The two organizations agreed to cooperatively develop models from which an alternative loan program could be formed.

Alternative Loans: Need, Funding and Loan Administration

The term, “alternative loans,” is the colloquial name for non-federal student loans. Students turn to this type of aid when federal student loans are not available or the limits have been reached and the student has remaining unmet financial need.

Federal student loans generally have substantial advantageous repayment terms that include controlled interest rates, deferments, consolidation, and some forgiveness opportunities. Alternative loans, in general, have few special benefits other than what can be gained by lowering the cost-of-funds, such as through tax-exempt bonds.

Several states such as Minnesota, Texas, and New Jersey manage state-run alternative loan programs. There is also a substantial private industry of alternative student loan providers such as Wells Fargo Bank and Sallie Mae.

<u>The need for alternative student loans</u>

Alternative loans are often seen as a type of aid used by upper-income and “non-needy” students; however, for the past several years it has become increasingly commonplace for many low- and middle-income students to turn to alternative loans in order to meet basic educational expenses.

This represents need that students are filling after all grants, work, scholarships, and subsidized federal loans have been received.

The Board's study of student aid records from 2003-04 indicates that alternative loans have become a fact of life for thousands of needy Washington students. According to the Board's Unit Record, in 2003-04 over 15,000 undergraduate students borrowed more that $8,000 in just that one year. Over 5,000 of the students borrowed more than $15,000 in just one year. Borrowing of over $8,000 in a single year probably represents alternative loans.

<u>The use of bond cap for student loans</u>

The federal bond cap was put into effect in 1986. The amount of the cap is based on the state's population and is recalculated every year. Up to about 15 percent of the bond cap is designated, by state statute, for student loans. For 2005 the student loan portion of Washington's bond cap is estimated to be about $75 million.

The Student Loan Finance Association (SLFA), an organization affiliated with the Northwest Education Loan Association (NELA), was the non-profit entity that previously received the benefits of the bond cap. In general it used the funds to support its secondary market function. It bought federally guaranteed student loans from local lenders who would then use the proceeds to extend additional loans to Washington students. Some repayment benefits may have also been extended to the students.

In 2004, a for-profit company called "SallieMae" purchased NELA. SallieMae, which was once an arm of the federal government, is now a private company and is the largest guarantor of federal student loans in the country.

<u>The interests of the HECB and the WHEFA</u>

The Washington Higher Education Facilities Authority (WHEFA) is the entity that provides the mechanisms for bond sales to be used for capital construction on private colleges' campuses. It is also a sort of umbrella organization for other entities authorized to use tax exempt bond proceeds. Its experience and authorizing statutes situate it to handle the intricacies of bond sales and bond management. WHEFA also initiated the investigation into the feasibility of setting up an alternative student loan program in Washington.

The Higher Education Coordinating Board (HECB) is well-positioned to provide all student aid administration and oversight. Its "student-centered" approach ensures that it will return the greatest financial benefits to students.

The HECB is the agency authorized in statute to administer all state student aid programs (RCW 28B.76.500). The Board administers 14 different student aid programs, including four conditional loan programs. It operates payment, tracking, fiscal, and receivable systems, and works on a daily basis with over 71 public and private institutions in all sectors.

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The agency is also responsible, by statute, to use state student aid programs to complement and coordinate with federal and institutional student aid programs (RCW 28B.92.040 [3]); and, by statute, to ensure that state aid programs follow the principle that state financial aid funding follows the student to the student's choice of institution of higher education (RCW 28B.92.020 [2b]).

Potential Models

There appear to be two basic models around which states have organized alternative loan programs:

1. A state agency run program, like the Student Education Loan Fund (SELF) operated by the Minnesota Higher Education Services Office (HESO). HESO is Minnesota's scholarship and grant agency like the HECB is Washington's.

2. A contracted program using a non-profit loan entity such as the NorthStar Company, which runs the "Total Higher Education" (T.H.E.) Loan program. NorthStar is also headquartered in Minnesota, but represents a class of entities that perform various similar loan services.

In both models, as well as in the student loan industry in general, significant portions of the loan operation–such as payments, billing, tracking, and collections–are often contracted to private companies that specialize in the service.

Issues for Investigation

- Bonding Authority and Bond Management
- Program Administration
- Start Up Expenses
- Bad Debt Reserve Fund
- Technology Platform
- Service Area
- Use of Advisory or Steering Committees
- Use of Private Service Providers

Relationship to Lending of State's Credit prohibition